The *Huawei* ruling and the duties of a dominant firm that voluntarily promised to give access to an input under Article 102

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Introduction

On July 16 2015, the Court of Justice (the “European Court” or “Court”) issued its ruling on the preliminary reference from the Landgericht Dusseldorf (Düsseldorf Regional Court) in Huawei Technologies Co v ZTE (“Huawei”).\(^1\) The request for a preliminary ruling had arisen in the context of an action concerning infringement of a patent between two Chinese telecommunications companies, Huawei and ZTE. Huawei holds a European patent declared as essential (SEP) to the Long Term Evolution (“LTE”) mobile telecommunications standard developed by the European Telecommunications Standards Institute (“ETSI”), a standard setting organization. Huawei made a commitment to ETSI to grant licenses to third parties on fair, reasonable and non-discriminatory terms (“FRAND”). ZTE markets base stations with LTE software that makes use of Huawei’s patent. After ZTE and Huawei failed to conclude a licensing agreement, Huawei brought an action for infringement against ZTE before the Düsseldorf Regional Court seeking, among other remedies, an injunction prohibiting the continuation of the infringement. ZTE claimed that, given its alleged willingness to license Huawei’s patents, Huawei’s action for an injunction was abusive. The German Court referred a series of questions to the European Court concerning the application of Article 102 TFEU to the injunction suit brought by Huawei against ZTE.

For the first time the Court was called upon to clarify whether, and if so, in what circumstances, an SEP holder abuses its dominant position by seeking injunctive relief against an unlicensed implementer of its technologies. The ruling was much awaited by patent and standard-setting communities that are affected by the ‘smartphone wars’ between leading ICT companies, including Samsung, Apple, Motorola, Microsoft, Google, and Huawei. On the one hand, patent owners try to enforce patents encumbered by a commitment to grant licenses on FRAND terms (‘FRAND commitment’) by asking courts to grant injunctions

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\(^1\) Case C-170/13, *Huawei technologies Co. Ltd v ZTE Deutschland GmbH*. 
preventing the sale of unlicensed rival products. SEP implementers, in turn, claim that seeking an injunction is an abuse of a dominant position, and, in some cases, lodge complaints with the antitrust authorities.

Moreover, the ruling was adopted against the background of a number of inconsistent precedents at national and EU level that have led to a high degree of uncertainty as to the lawfulness under Article 102 TFEU of certain forms of conduct of SEP holders. In the case at issue the Düsseldorf Regional Court had to decide the case against the background of two of these inconsistent sets of precedents. On the one hand, German courts have applied the principles laid down by the German Federal Court (Bundesgerichtshof) in the Orange-Book-Standard judgment, according to which seeking an injunction on patents essential for a de facto standard is abusive if the unauthorized implementer (i) unconditionally offers to enter into a license agreement with the plaintiff at a rate that is so high that the plaintiff cannot reasonably refuse or at a rate that is to be determined by the plaintiff but is subject to court review and adjustment, and (ii) behaves as if it were an actual licensee by paying royalties and rendering accounts. Should the Düsseldorf Regional Court apply such principles, it could issue the requested injunction. On the other hand, the European Commission, at the time the Düsseldorf Regional Court referred the case, issued a press release in Samsung suggesting that an SEP holder abuses its dominant position by seeking an injunction against an authorized implementer if (i) the SEP holder had made a FRAND commitment, and (ii) the implementer was willing to negotiate a license. Should the Düsseldorf Regional Court apply the principles laid down by the Commission, it could dismiss Huawei’s action for injunction as an abuse.

The ruling is highly significant. The Court rejected Orange-Book Standard, went beyond the approach of the Commission, and provided antitrust authorities and courts with a new test to assess an SEP holder’s actions under Article 102 TFEU.

The Ruling

Firstly, the European Court pointed out that, for the purposes of providing an answer to the Düsseldorf Regional Court, it had to ‘strike a balance between maintaining free competition… and the requirement to

2 Federal Court’s judgment of May 6, 2009, case KZR 39/06.
safeguard...proprietor’s intellectual-property right and its right to effective judicial protection." Subsequently, the Court made a general introduction on the settled case law that consistently holds that the exercise of an exclusive right linked to an intellectual property right cannot itself constitute an abuse of a dominant position, and only in ‘exceptional circumstances’ may be deemed abusive under Article 102 TFEU.

The Court, however, noted that the case at issue was different from the cases that gave rise to the settle case law on the exercise of intellectual property (“IP”) rights in two important respects. First, the patent at issue was essential to a standard established by a standardization body and it was indispensable to all competitors manufacturing products that comply with the standard to which it is linked. Therefore, according to the Court, an SEP holder could prevent competitors' products from ‘appearing or remaining’ in the market and reserve the manufacture of those products for itself. Second, the patent at issue obtained SEP status in return for its proprietor’s FRAND commitment. Referring to these circumstances, the European Court held that, ‘having regard to the fact that an undertaking to grant licenses on FRAND terms creates legitimate expectations on the part of third parties that the proprietor of the SEP will in fact grant licenses on such terms, a refusal to grant a license on those terms ‘may, in principle, amount to an abuse of dominance’.

The abusive nature of such a refusal may, in principle, be raised as a defense to actions for a prohibitory injunction or for the recall of products. The European Court, however, pointed out that an SEP holder is obliged only to grant licenses on FRAND terms and may not be entirely deprived of the right to have recourse to legal proceedings to ensure effective enforcement of its exclusive rights against unauthorized implementers. The latter, in turn, should obtain a license prior to any use. In order to ‘ensure a fair balance between the interests’ of SEP holders and implementers, the Court held that an SEP holder may have recourse to legal proceedings in two circumstances without infringing

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4 Ruling, paragraph 42.
6 Ruling, paragraph 52.
7 Ruling, paragraph 53.
8 Ruling, paragraph 53.
9 Ruling, paragraph 55.
upon Article 102 TFEU. First, an SEP holder may bring actions against alleged infringers for a prohibitory injunction or for the recall of products after complying with certain requirements. Notably, an SEP holder must alert the SEP implementer of the alleged infringement. After the implementer has expressed its willingness to conclude a licensing agreement on FRAND terms, the SEP holder must present a detailed written offer for a license on FRAND terms, specifying the amount of the royalty and the way in which it is calculated. The SEP implementer, in turn, must respond diligently, \textit{“in accordance with recognized commercial practices in the field”},\footnote{Ruling, paragraph 65.} and in a good faith to the SEP holder’s offer and must not engage in delaying tactics. In case the SEP implementer does not accept the offer, it must submit, promptly and in writing, a specific counter-offer on FRAND terms. If no agreement is reached following the counter-offer, the amount of the royalty may, by common agreement, be determined by a third party. Moreover, an SEP implementer that is already using the technology must provide appropriate security and be able to render accounts. On the other hand, if the implementer does not diligently and promptly respond to the offer, the SEP holder can seek an injunction. Finally, the Court clarified that SEP implementers can challenge the validity, essentiality and infringement of the patents in conjunction with licensing agreement negotiation and after the license agreement.

Second, an SEP holder does not abuse its dominant position by bringing action for infringement of its patent and seeking the rendering of accounts in relation to past acts of use or an award of damages as those actions do not have an impact of the manufacturing of competing products, \textit{i.e.} do not prevent products complying with the standard at issue manufactured by competitors from appearing or remaining in the market.

\textbf{Violating FRAND Commitments as an Abuse of Dominance}

The ruling confirmed that seeking, or threatening to seek, injunctions for SEPs encumbered by a FRAND commitment may be abusive under Article 102, and provided antitrust authorities and courts with a common legal framework to assess the behavior of SEP holders.

The European Court left many questions open. First, at the outset of the ruling the Court noted that the existence of Huawei’s dominant
position was not in dispute, and, therefore, decided not to address the issue of dominance, and to limit its analysis to the issue of abuse. The existence of a dominant position in the relevant market, however, is the pre-condition to the application of a prohibition under Article 102 TFEU. Establishing such a position is all the more important in cases concerning the application of Article 102 TFEU to the conduct of the owner of intellectual property rights, as the exercise of such rights may be deemed abusive only in ‘exceptional circumstances’. The ruling at issue leaves open the possibility that through the ownership of a single patent essential to a standard, the owner can prevent competitors from manufacturing products incorporating the standard – irrespective of the existence of other SEPs – and could therefore be deemed to hold a dominant position. In this regard, it is worth noting that the Advocate General cast some doubt on whether it is appropriate to presume an SEP holder’s dominance, and stated that he shared the view of the Netherlands Government that the fact that an undertaking owns an SEP does not necessarily means it holds a dominant position under Article 102 TFEU. National courts are to determine on a case-by-case basis that such a position exists.

The Court also focused on an SEP holder’s right to seek an injunction even if it has given a FRAND commitment, and, thus, dealt with the negotiating process rather than with the FRAND terms. The Court did not give guidance on what amounts to FRAND terms and how the FRAND royalty should be calculated. It also did not clarify a number of issues that might raise during the negotiations between SEP holders and implementers, including whether an implementer can submit a counter-offer even if the SEP holder’s offer is FRAND, or what should happen if both parties claim their offer is FRAND or do not agree to have the matter decided by a third party. In sum, the European Court left national courts to decide FRAND disputes on a case-by-case basis and is unlikely to reduce FRAND litigation.

The fact that the determination of the FRAND terms is left to the negotiations between the parties and the national courts does not make the ruling at issue less significant. Firstly, the Court identified an independent form of abuse of a dominant position under Article 102 TFEU. This is not uncommon, as the concept of abuse of a dominant position is open-ended, and over the years EU courts have occasionally identified new forms of abuse in order to fill the gaps in relation to internal market issues and, thus, ensure the effectiveness of EU law. What is significant is the legal standard used by the Court to prevent SEP holders from abusing their dominant position against implementers
that rely on the FRAND commitment.

**Avoiding the Abusive Litigation Theory**

It is worth noting that the European Court did not apply the principles on ‘abusive litigation’ established by the General Court in *IIT*\(^1\) and *Protégé*,\(^2\) two cases in which the General Court held that bringing legal proceedings may be an abuse if two cumulative conditions occur: (i) the legal action of the dominant firm cannot reasonably be considered to be an attempt to assert its rights, and is only aimed at harassing the opposing party, and (ii) was taken in the framework of a plan to eliminate competition. In the ruling at issue, the Court’s emphasis on the ‘legitimate expectations’ of the SEP implementers shows that its main concern is establishing rules to protect those expectations.

Moreover, the Court distinguished the case at issue from the cases that gave rise to the settled case law on refusal to license an IP right. Notably, it is a well established principle that the exercise of an IP right may be abusive if the IP right owner refuses to give access to a product or service indispensable for carrying on a particular business and three other cumulative conditions occur: (i) that the refusal prevents the emergence of a new product for which there is a potential consumer demand, (ii) that it is unjustified, and (iii) that it excludes any competition on a secondary market. In *IMS*,\(^3\) the European Court held that this principle also applies to the conduct of a copyright owner seeking an injunction to enforce its right.

The Court did not approach the case at issue in terms of ‘refusal to license’ an IP right for two reasons. First, it took into account the fact that the FRAND commitment puts an SEP holder in a different position than other patentees. Indeed, by making the FRAND commitment, the SEP holder waives its right to refuse to offer a license to those seeking one in exchange for the opportunity to have its patented technologies included in the standard. The Court, however, did not rule that the FRAND commitment is a contract.\(^4\) Rather, it emphasized the legitimate expectations of implementers that an SEP holder will grant licenses and, therefore, engage in good faith negotiations to this effect. Second, the Court did not need to rely on the settled case law on IP right licensing.

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\(^1\) Judgment of July 17, 198, case T-11/96.
\(^3\) See footnote 5.
\(^4\) The Court could not give such a ruling as Contract law typically falls under Member States’ jurisdiction.
because the FRAND commitment itself is aimed at preventing outright refusal to deal and SEP holder’s setting unfair, unreasonable and discriminatory royalties and other commercial conditions. Consequently, the Court held that SEP holder’s bringing an action for a prohibitory injunction or the recall of products may, in principle, be abusive even if the conditions established in IMS do not occur. Notably, the Court assumed that an SEP is essential to a standard established by a standardization body, and is indispensable to manufacture products that comply with the standard. It did not suggest, however, that the Düsseldorf Regional Court establishes that seeking an injunction excludes any competition in the market. Moreover, the Court pointed out that an SEP holder may not seek an injunction unless it complies with the specific requirements it laid down. In this way, the Court seems to reduce the range of justifications that an SEP holder may put forward to escape the application of Article 102.

**Expanding Exploitive Abuses**

In fact, the Court identified a new form of abuse. Such abuse is ascribable to the category of the ‘exploitative abuses’ under Article 102. Those abuses comprise any conduct that harms the trading partners of a dominant firm by ‘directly or indirectly imposing unfair purchase or selling prices’ under Article 102 (2) (a). Over the years the EU antitrust authorities and courts have very rarely applied the prohibition of exploitative abuses.

In the few past years, however, there has been a revival of the concept of ‘exploitative abuse’. Two seminal cases, *Deutsche Telekom v Commission*,\(^{15}\) and *Teliasonera Sverige*,\(^{16}\) dealt with the application of Article 102 (2) (a). In both cases, the Court held that such a provision prevents a dominant firm, without having an objective justification, from abusing its dominant position by selling an input to its competitors on a downstream market at a price which does not enable those competitors to compete effectively because the spread between the price applied in the upstream market and those applied in the downstream market is not sufficient to cover the specific costs which the dominant firm itself must incur in order to gain access to that retail market (margin squeeze). According to the Court, margin squeeze is an independent form of abuse and its abusive nature derives from the ‘unfairness of the spread’\(^{17}\)

\(^{15}\) Judgment of October 14, 2004, case C-280/08.

\(^{16}\) Judgment of February 17, 2011m case C-59/09.

\(^{17}\) *Deutsche Telekom v Commission*, paragraph 167.
between prices. Moreover, in *Teliasonera Sverige*, the Court distinguished the case at issue from the cases on refusal to deal because the undertaking voluntarily agreed to provide the input. The margin squeeze was abusive even if the dominant firm did not have either (i) a regulatory obligation to supply, or (ii) an antitrust obligation to supply because the input was indispensable. From this the Court suggested that if the dominant firm voluntarily gives access to an input, the commercial conditions under which it gives access must necessarily be *fair*.18

In the Huawei ruling, the Court developed these principles in the context of standard setting activities. As in *Teliasonera Sverige*, it distinguished the case at issue from the cases of refusal to deal. It also focused its attention on the SEP holder’s FRAND commitment. The Court did not suggest that the Düsseldorf Regional Court applies Article 102 (2) (a), as the issue was not the determination of FRAND terms. The Court, however, carried out the same ‘*fair balance*’ test between the parties’ interests19 it applies when it must establish whether contractual conditions are unfair under Article 102 (2) (a). 20

**Conclusion**

Not only is the *Huawei* ruling an example of the ‘revival’ of the concept of ‘exploitative abuse’, but it also shows that the European Court is willing to scrutinise the fairness of the conduct of a dominant firm that voluntarily agrees, or promises, to give access to an input under Article 102.

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19 Ruling, paragraphs 54-59.
20 See *BRT v SABAM* (judgment of May 27, 1974, case C-127/73), in which the Court held that an abuse could consist in the fact that a copyright association that enjoys a *de facto* monopoly in the management of copyrights imposes on its members obligations which are not absolutely necessary for the attainment of its object and thus limit ‘unfairly’ a member’s freedom to exercise his copyright. According to the Court, for this appraisal, account had to be taken of all the relevant interests to ensure a balancing between the requirement of maximum freedom for members to dispose of their works and the effective management of their rights by the undertaking. Thus, a condition going beyond what is absolutely necessary for the achievement of one party’s objectives is an ‘unfair’ limitation of the freedom of the other party.